



Personal Guarantors Liable for Corporate Debt

Why in News

The [Supreme Court of India](#) has upheld the **Central Government 2019 notification** that allows lenders to **initiate insolvency proceedings against personal guarantors**.

- It will allow the lenders to recover their remaining debt from personal guarantors following the conclusion of the [Corporate Insolvency Resolution Process \(CIRP\)](#).
- The CIRP is a recovery mechanism made available to creditors as under the Insolvency and Bankruptcy Code, 2016 (IBC).

Key Points

▪ Background:

- **Definition:** A personal guarantor is a person or an entity that promises payment of another person's debt, in case the latter fails to pay it off.
- **Central Government Notification 2019:** It brought personal guarantors to companies facing insolvency proceedings under the purview of the [Insolvency and Bankruptcy Code \(IBC\)](#).
 - **Section 1(3)** of the IBC code allows the central government to notify different provisions of the code at different dates, to allow its implementation bit by bit.
 - These rules and regulations lay down the process for **initiating insolvency resolution** and **bankruptcy proceedings** against personal guarantors to corporate debtors, inviting claims from creditors, withdrawal of such applications, etc.
- **Simultaneously Proceedings:** The new rules and regulations will allow creditors to simultaneously proceed against the principal borrower, i.e. the company, and the personal guarantor before the [National Company Law Tribunal \(NCLT\)](#).
 - Until now, the IBC code only covered insolvency resolution and liquidation of corporate debtors.
- **Counter Argument:** The Central Government did not have the power to bring in IBC provisions selectively to personal guarantors of corporate debtors.
 - The singling out of guarantors is **violative of the fundamental right to equality**.

▪ Supreme Court Verdict:

- **Intrinsic Connection:** There was an "intrinsic connection" between personal guarantors and their corporate debtors.
 - **Section 60(2)** of the IBC Code had required the bankruptcy proceedings of corporate debtors and their personal guarantors to be held before a **common forum, the NCLT**.
- **Adjudicating Authority:** The adjudicating authority for personal guarantors will be the

NCLT if a parallel resolution process is pending in respect of a corporate debtor for whom the guarantee is given.

- The side by side bankruptcy proceedings before the same forum for both the corporate debtors and their personal guarantors **would help the NCLT consider the whole picture.**

▪ **Concept of Guarantee:** The concept of 'guarantee' is derived from **Section 126** of the **Indian Contracts Act, 1872.**

- A contract of guarantee is made among the debtor, creditor and the guarantor.
- If the debtor fails to repay the debt to the creditor, the burden falls on the guarantor to pay the amount.
- The creditor reserves the right to begin insolvency proceedings against the personal guarantor if the latter does not pay.

▪ **Possible Benefits:**

- By initiating the insolvency proceedings against personal guarantors, there is a greater likelihood that they would "arrange" for the payment of the debt to the creditor bank in order to obtain a quick discharge.
- The creditor bank would be prepared to take a haircut or forego the interest amounts so as to enable an equitable settlement of the corporate debt, as well as that of the personal guarantor.
- It would result in **maximising the value of assets and promoting entrepreneurship.**

Note

- **Insolvency:** It is a situation where individuals or companies are unable to repay their outstanding debt.
- **Bankruptcy:** It is a situation whereby a court of competent jurisdiction has declared a person or other entity insolvent, having passed appropriate orders to resolve it and protect the rights of the creditors. It is a legal declaration of one's inability to pay off debts.

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